

Global Equity Views

Themes and implications from the *Global Equity Investors Quarterly*

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In brief

- A major shift in expectations for monetary policy drove markets sharply higher toward the end of 2023. The MSCI World Index enjoyed one of the best two months of returns in the last 50 years. Cyclical stocks performed well and risk was generously rewarded.
- From a fundamental perspective, 2024 does look like a better year than 2023. Our research team sees global corporate earnings growing around 10% after two years of little or no growth in most regions. But the recent rally and higher valuations have anticipated much of this, especially for the best companies.
- Overall, our portfolio team takes a neutral view on markets. Most portfolio managers expect a broadening of market leadership this year but still prefer higher quality stocks, while there is some near-term caution over the big AI winners of 2023. We suggest rebalancing and diversifying — usually sensible advice, it is especially relevant after such a narrow market last year.

Taking stock

After surging almost 60% in the post-pandemic boom of 2021, global corporate profits have stagnated over the last two years. Now, the outlook appears to be brightening again. Our equity research team sees 10% earnings growth this year, well balanced across both regions and sectors. And despite a tremendous surge in stock prices at the end of last year, valuations in most markets and most sectors look middling rather than extreme.

Our portfolio managers are reasonably optimistic about prospects from here, although many still wonder whether the macro consensus has become rather too optimistic about rates, inflation and growth in recent weeks. In the U.S., many see the best opportunities in the 493 stocks that were less favored last year, especially if the economy continues to expand and profits stay healthy.

China remains the clear outlier among the major markets, in the grip of a deep and painful bear market. Contrarian indicators are beginning to send a more positive message. But for a sustained rally in China we think investors will need more clarity about government policy toward the corporate sector, and that may well remain elusive. For now, Japan is more likely to stay in focus as an investment destination in Asia.

The 2024 profits outlook still looks solid

After surging almost 60% in the post-pandemic boom of 2021, global corporate profits have stagnated over the last two years. The picture has been nuanced and complicated, with rolling setbacks at different times across the technology, health care and energy sectors. But the outlook appears to be brightening. Our U.S. equity research team sees 12% earnings growth this year, well balanced across both regions and sectors.

In our view, the sectors where profits have recently lagged (health care, semiconductors) have largely worked their way through periods of weaker demand. Meanwhile the reliable growth companies just keep going. The so-called “Magnificent 7” should contribute nearly six percentage points to overall S&P 500 growth this year, for example. Another two percentage points will come from the absence of big losses in the health care sector that resulted from a collapse in demand for pandemic vaccines.

In other words, the rest of the market, or about 490 companies, need to produce the remaining four percentage points of growth to prove our +12% forecast correct. This seems not too much of a stretch, given

that nominal revenues are still growing and margins in many sectors are actually trending higher of late.

This rather sunny picture is of course subject to the usual economic uncertainties, but from a bottom-up perspective the outlook for profit growth this year is better than we have seen for a while. And in the long run, profits matter most (**Exhibit 1**). Last year, staying anchored on actual profits was a good way to avoid wildly fluctuating macroeconomic forecasts, and the message from the corporate sector remains reassuring.

Prepare for an “AI autumn?”

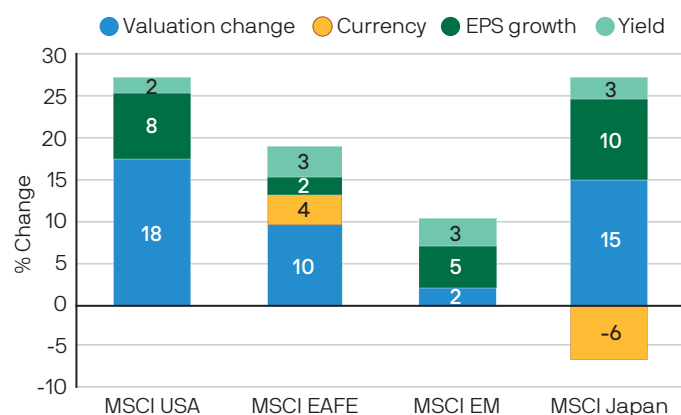
Excitement over the potential for generative AI was one of the major investment themes of 2024, and a key factor in the market leadership of the technology sector. What’s next?

To help answer that question, our technology analysts have been spending time with CFOs and chief information officers from a wide range of firms across different industries to gauge how and when AI enthusiasm might translate into actual spending and investment decisions. While AI’s long-term prospects remain very bright, we see a risk that markets become frustrated with a lack of progress in the near term.

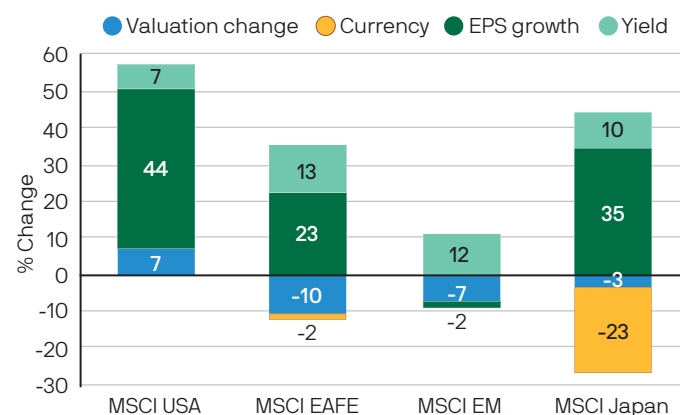
Multiple expansion was a tailwind in 2023, while fundamentals have driven global equity returns since 2019

Exhibit 1: Index return decomposed by valuation change, currency, earnings growth and yield

1A: Index return decomposition 2023



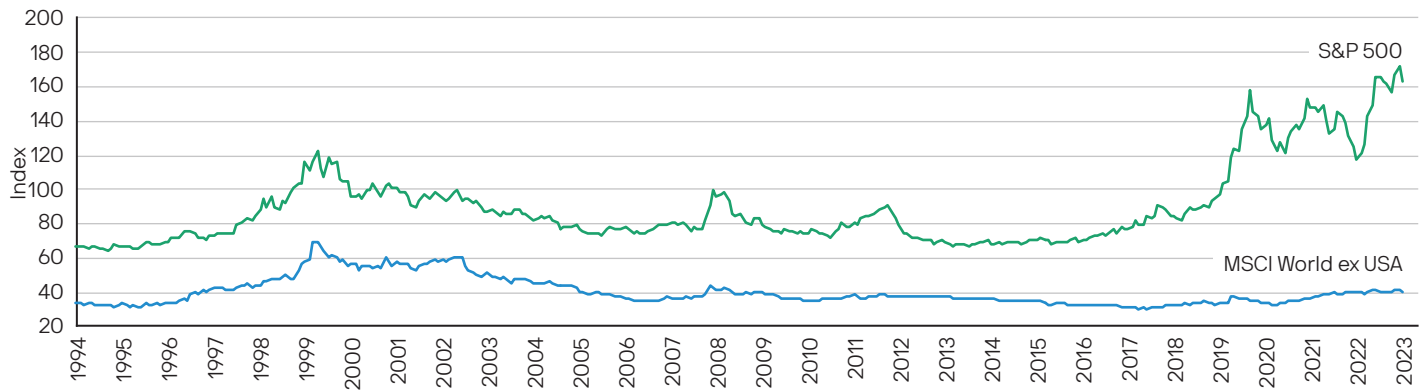
1B: Index return decomposition 2020–2023



Source: MSCI, J.P. Morgan Asset Management. Chart shows decomposition of the index total return into sub-components: Currency: difference in total return in USD and in the index currency; Yield: difference between return of the total return index and price index in the index currency; EPS growth: change in value of the index forward EPS estimate between the beginning and the end of the period; Valuation change: difference in return of the price index in the index currency and the EPS Growth component. Interaction term is added to the EPS Growth component. Period of the analysis for the RHS chart is from December 31, 2019–December 29, 2023. Period of the analysis for the LHS chart is from December 31, 2022–December 29, 2023.

Index concentration in the U.S. is at highest levels since the 1970s, driven by the Magnificent 7 and AI enthusiasm

Exhibit 2: Index concentration (Herfindahl-Hirschman Index)



Source: FactSet, MSCI, J.P. Morgan Asset Management. Chart shows Herfindahl-Hirschman index calculated using index constituents' weights. Period: December 30, 1994–December 29, 2023. The Herfindahl Hirschman Index (HHI) is a measure of industry concentration and an indicator of the amount of competition between firms. It is calculated by squaring the market share of each firm competing in the market and then summing the resulting numbers. In the case of the equity index, HHI is calculated using index weights instead of market share.

The companies that we meet with have no problem finding the money for AI investments, and spending is steadily increasing. But questions of data governance (security, privacy, ethics) will likely restrain progress for a while. It's not quite an AI winter, but this may be a quieter year than 2023 for investors in this space, with better opportunities to build positions in potential long-term winners.

Meanwhile the stock market is more concentrated than at any time in the last 50 years, with AI enthusiasm an important contributing factor (**Exhibit 2**). Many of our U.S. portfolio managers think at least some of the other 493 stocks in the S&P 500 benchmark will offer better incremental investment opportunities this year.

Japanese equities mount a comeback

After AI, the renaissance in Japanese equities was one of the brighter spots in the global equity markets during 2023. Can we expect more?

Our research team has been addressing three questions. First, is the market's newfound enthusiasm for better corporate governance overdone? We think not. Activist campaigns and leveraged buyouts are

rising steadily, and we see plenty of opportunity ahead. Second, is deflation in Japan finally over? Companies tell us that wage increases are here to stay. We see wages rising in 2024 at the fastest pace in 30 years, which is an important positive for spending and a sign that the dark days of deflation are ending.

And finally, does potential reversal in the yen, which looks deeply undervalued, present a risk to profits? Yes it does, but Japanese corporate profits are now less sensitive to currency moves. In aggregate, Japanese stocks have not quite reached their 1989 highs, and valuations still look reasonable. More recovery could well lie ahead. Within Japan, the recovery in value stocks has gone further than in other major markets and we anticipate a return back toward the longer term winners that we have typically favored in our portfolios.

Exhibit 3 (next page) shows the views of our team members. Overall, they are broadly neutral, prefer quality stocks and expect a broadening of market leadership.

Views from our *Global Equity Investors Quarterly*, January 2024

Exhibit 3



Source: A subset of results is shown from a January 2024 survey of *Global Equity Investors Quarterly* participants. These responses are taken from a quarterly survey representing 45 CIOs and portfolio managers across global equities.

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